



Securities Industry Association

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August 2, 2000

The Honorable Arthur Levitt, Jr.
Chairman
U.S. Securities and Exchange Commission
450 Fifth Street NW
Washington, D.C. 20549

Re: GAO Report on Online Trading

Dear Chairman Levitt:

The Committee on Technology and Regulation and the Online Brokerage Legal Committee (“the committees”) of the Securities Industry Association (“SIA”)¹ are writing in reference to the letter of June 8, 2000, to you from Representatives John Dingell, Ron Klink, Edward Markey and Edolphus Towns, regarding the U.S. General Accounting Office Report entitled “Online Trading: Better Investor Protection Information Needed on Brokers’ Web Sites” (GAO/GGD-00-43, May 9, 2000). We note that the Commission’s Office of Compliance, Inspections and Examinations appears to be reviewing issues similar to those raised by the GAO report. Specifically, we wanted to provide you with our views on the two recommendations in the GAO report.

The GAO report recommends that the SEC require broker-dealers with online trading systems to maintain consistent records on system delays and outages and their related causes, and to disclose on their web sites the potential for service disruptions. The GAO report also recommends that the SEC ensure that online brokers include information on their web sites about key investor protection areas, such as trading risks, margin requirements, privacy policies, and best execution.

¹ The Securities Industry Association brings together the shared interests of more than 740 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans. The industry generates more than \$300 billion of revenues yearly in the U.S. economy and employs approximately 700,000 individuals. (More information about the SIA is available on its home page: <http://www.sia.com>.)

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We note the tremendous technological advances that have been achieved in recent years. There is no sector of our economy that has not been indelibly altered by the pace of technological change. In the securities industry, technological change has coincided with unprecedented increases in trading volume. Securities firms are engaged in intense competition to provide customers with better, faster, more efficient, and more reliable processing of orders and executions. Spending on infrastructure is only constrained by the ability of technology manufacturers to bring new products to market. In addition to increased customer demand and competition, the industry has confronted and is confronting such all-encompassing technological challenges as Year 2000, decimal conversion, T+1 settlement, OATS, infrastructure capacity, and price transparency for the fixed income market. In each case, the industry has successfully marshaled the necessary resources and has met or is meeting the challenge. Given the realities of today's technological and competitive challenges and the industry's demonstrated record of confronting such challenges head-on, there should be no doubt about the industry's resolve to tackle any operational issue.

We believe the GAO's recommendations may be premature. As you know, the SIA's Online Brokerage Committee and the NASDR's E-Brokerage Committee have been meeting extensively throughout this year on the issues addressed in the GAO report. These committees have met with SEC Commissioners, state securities regulators and the NASDR staff. The SIA and NASDR committees are working toward a set of best practice recommendations concerning customer education, disclosure and online brokerage. We believe these industry and self-regulatory initiatives, undertaken in the best spirit of cooperation for the protection of investors, should be given a fair chance to succeed before the Commission considers additional layers of federal regulation.

Moreover, we believe the focus of the report is misplaced. The GAO's distinction between online and traditional firms is quickly disappearing as most traditional firms now offer online services to their customers. Online access is rapidly becoming simply one means by which almost all customers can transmit orders to their brokers. Order entry, online or otherwise, is just one of a multitude of operational processes that occur between the time an order is entered and the time the customer receives notice of an execution. All broker-dealers are dependent on an array of technological systems to perform trading, order routing and operational functions. In our view, it does not make sense to adopt regulation directed at one channel of customer access. The SEC's guidance concerning systems outages and availability, as well as the operational capability rule it proposed in 1999, have been directed at general operational capability, not just the online access channel.² By focusing exclusively

² See SEC Division of Market Regulation Staff Legal Bulletin No. 8 (September 9, 1998); SEC Exchange Act Release No. 34-41142, Operational Capability Requirements of Registered Broker-Dealers and Transfer Agents and Year 2000 Compliance (March 5, 1999).

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on the online order entry channel, the GAO report oversimplifies the operational issues and undervalues the studied approach the SEC has pursued in addressing such issues.

The SIA has long advocated providing investors with disclosures and educational materials to help them make more informed investment decisions. However, just as with operational capacity, these are issues that all brokerage firms face. For example, all firms are obligated to disclose information about how they route their customer trades for execution and whether they receive payment for order flow.³ Similarly, all firms are obligated to seek the best execution of their customers' trades, regardless of whether the trade is placed in person, over the telephone, or online. By mischaracterizing these as online issues, the GAO report (which did not even review other types of firms) creates the erroneous impression that operational capability concerns arise only when placing orders online.

In sum, while the GAO report highlights a number of important issues, they are issues that the Commission should allow the industry and the self-regulatory process to address. While SIA does not believe the report sets out an adequate or up-to-date basis for further regulation, we remain committed to working with the SEC and the SRO's to understand and address operational issues. We appreciate your taking the time to consider our views on this important subject. Should you wish to discuss these matters further please contact Stuart J. Kaswell, Senior Vice President & General Counsel, at 202-296-9410.

Very truly yours,

Michael L. Michael, Chairman
Committee on Technology
Regulation

Michael Hogan, Chairman
Online Brokerage Legal Committee

cc: Annette Nazareth, Director
SEC Division of Market Regulation

Robert L.D. Colby, Deputy Director,
SEC Division of Market Regulation

³ See SEC Rule 11Ac1-3.